

GAO

United States General Accounting Office

Report to the Chairman, Committee on
Foreign Affairs, House of
Representatives

January 1990

FOREIGN ECONOMIC ASSISTANCE

Better Controls Needed Over Property Accountability and Contract Close Outs



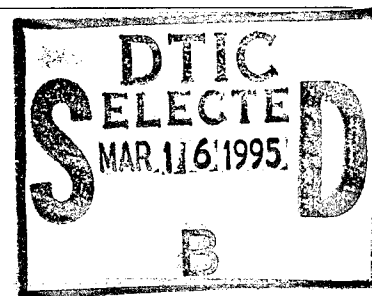
19950315 036

National Security and
International Affairs Division

B-236711

January 22, 1990

The Honorable Dante B. Fascell
Chairman, Committee on Foreign Affairs
House of Representatives



| | |
|--------------------|-------------------------------------|
| Acquisition For | |
| UNTS GRAM | <input checked="" type="checkbox"/> |
| DTIC TAB | <input type="checkbox"/> |
| Unannounced | <input type="checkbox"/> |
| Justification | |
| By | |
| Distribution/ | |
| Availability Codes | |
| Dist | Avail and/or Special |
| A-1 | |

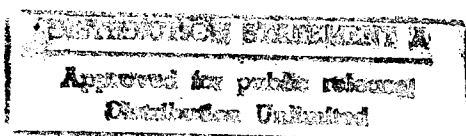
Dear Mr. Chairman:

This report is our initial response to your April 20, 1989, request that we review options for streamlining and revising the Agency for International Development's (AID) contracting and procurement system. This report responds to your concerns about the adequacy of AID's internal controls over its contracts.

In this report we examine AID's procedures for (1) maintaining accountability for both AID-owned and cooperating country titled nonexpendable property in the possession of contractors and (2) closing out and auditing expired contracts in conformance with federal and AID contracting policies and regulations. Our review was conducted at AID/Washington and at AID missions in Ecuador and Bolivia. A full discussion of our objectives, scope, and methodology is in appendix I. We will provide a separate report on the other concerns outlined in your request.

Results in Brief

We found that (1) AID does not exercise adequate accountability for project-funded nonexpendable property in the possession of contractors and (2) AID's current policy and reporting requirements are not sufficient to ensure systematic close out and final audit of completed contracts at the two overseas missions we visited. AID internal audits and evaluations have identified similar weaknesses in these areas, but AID audit recommendations have not been satisfactorily resolved. The continuing existence of these weaknesses makes the agency unnecessarily vulnerable to the misuse by contractors of AID-financed property, and can result in delays in the deobligation or decommitment of funds, unfulfilled contractual commitments, and the lack of assurance that only allowable contract costs have been paid.



DTIC QUALITY INSPECTED 4

Lack of Accountability for Project-Funded Nonexpendable Property

AID regulations require that AID maintain accountability for project-funded nonexpendable property in the possession of its contractors. Our analysis showed that AID is not adequately complying with these regulations, and therefore, does not know the value or condition of this property, or whether proper disposition is made for such property at the completion of contracts. Because AID did not have adequate records, we could not determine the quantity, type, or value of AID's project-funded property in the possession of contractors. However, prior AID Inspector General reviews indicate that the value of such property is significant.

AID regulations define nonexpendable property as property that is complete in itself and does not lose its identity or become a component of another article when put into use. Further, it is defined as being durable, with an expected service life of 2 years or more and a unit cost of more than \$500. Nonexpendable property typically includes computer hardware and software, motor vehicles, office furniture and equipment, and appliances.

AID regulations require contractors to submit to AID contracting officers annual and final inventory reports of AID-owned nonexpendable property in their possession. AID Handbook 19 procedures require AID's Office of Financial Management to maintain a general ledger account for AID-owned property in the possession of contractors and to compare that data with annual property inventories submitted by contractors. AID procedures do not require similar accountability for cooperating country titled property. However, before contracts are closed out, contractors are required to submit to AID a final inventory of nonexpendable property they have in their possession but which is titled to the cooperating country.

We found that AID's Office of Financial Management was not accounting for and reporting on project-funded, AID-owned nonexpendable property as called for by Handbook 19. Officials stated that the failure to implement a system of accountability for project-funded nonexpendable property can be attributed to the following factors:

- The requirement for a general ledger account of AID-owned property in the possession of contractors has not been met because the volume of vouchers generated by contractors throughout AID is too large for AID's limited staff resources to review.
- Contracting officers have not been submitting to the Office of Financial Management the annual reports of contractor property inventories that are necessary for reconciliation with a general ledger account.

Our review at the AID missions in Ecuador and Bolivia showed that these missions also were not accounting for project-funded nonexpendable property in the possession of contractors, whether owned by the United States or by the cooperating country. Neither mission had records identifying the amounts or types of such property in the possession of contractors, or whether such property had been properly disposed of for expired contracts. Based on discussions with mission officials, we believe that inadequate accountability can be attributed to (1) a general lack of priority for project-funded property accountability, (2) the failure of contractors to submit annual and final inventory reports, and (3) inadequate closure of completed contracts, which requires final inventories of both AID-owned and cooperating country titled nonexpendable property in the custody of contractors.

Although the missions could not provide information on the quantity or value of nonexpendable property in the possession of contractors, our analysis of mission contracts indicated that many contracts provide for the procurement of such property. For example, a contract administered by the mission in Bolivia, valued at about \$2.3 million, provided for the purchase of several computers and copier equipment for the contractor's use, and other office equipment for AID's use. The property purchased by the contractor was valued at \$318,000, and was included in the contract's funding for other direct costs.

In discussing this issue with the regional contracting officer for Ecuador, Bolivia, and Peru, he agreed that there is inadequate accountability and control over property in the possession of contractors at the missions in his region. In early 1989, the contracting officer sent letters to 11 contractors requesting a list of all property procured with contract funds, but only about four of the contractors replied.

One contractor who responded stated that property worth about \$14,000 was being used in Bolivia and about \$8,000 of such property was being used at the contractor's office located in the United States. Another contractor, based in Costa Rica but performing contract services for the mission in Peru, reported that under his Peruvian contract he purchased computer equipment and office furniture worth about \$10,000 for his office in Costa Rica. The contracting officer stated that he was unaware of the property in Costa Rica, and had no way of knowing about such property if it had not been reported.

AID procurement officials in Washington stated that the lack of accountability for project-funded nonexpendable property is a problem for

many overseas missions. This is particularly true of property titled to the cooperating country. However, these officials did not know the extent to which such property may be at risk for misuse or improper disposition when the contract is completed.

Because AID has not identified and reported the amount and type of nonexpendable property in the possession of contractors, it does not know how much property has been provided to contractors. However, we believe that the amount of nonexpendable property unaccounted for by AID may be significant. For example, property funded by just one contract included AID-owned computers and other equipment that cost \$102,000 and similar property titled to the cooperating country that cost \$60,000. AID had about 6,100 technical services contracts and grants active in fiscal year 1988 with total obligations of about \$4.4 billion. An unknown portion of this amount was for nonexpendable property.

Prior Audits

The AID Inspector General has identified the lack of accountability for nonexpendable property in the possession of contractors as a significant problem, but the problem has not been corrected. For example, in March 1985, the Inspector General reported that an examination of 122 contracts, including AID/Washington and mission contracts, showed that at least 24 included nonexpendable property that had not been accounted for or properly disposed of. The property had an estimated cost of \$4 million. The Inspector General concluded that, in several cases, AID should have been reimbursed for lost, damaged, or misused property, but was not. Similar to our findings in Bolivia and Ecuador, the lack of records precluded a complete accounting of property. The Inspector General's report recommended that AID establish a system of accounting and control over AID-funded nonexpendable property.

The report also noted that the Office of Financial Management was making only limited progress in its efforts (initiated in 1984) to develop a property listing for active contracts. Our review shows that in the 4 1/2 years since the Inspector General's report, AID has made no progress in establishing accountability and control over project-funded nonexpendable property.

Improvements Needed in Closing Out Expired Contracts

The AID office administering a contract is responsible for timely initiating contract close-out procedures to ensure, among other things, that (1) property clearance has been received, (2) all interim or disallowed costs have been settled, (3) the contractor's final invoice has been submitted, (4) excess funds are deobligated or decommitted,¹ and (5) a contract audit is completed. Our review showed that many AID missions do not have a system for ensuring that contracts are closed out, as required by federal regulations. Also, AID does not know if all expired contracts administered by the missions are being closed out because it does not have an information system to keep track of this information.

AID does have a system for closing out contracts administered in Washington by the Office of Procurement, and the AID Procurement Executive has directed the overseas missions to establish a similar procedure tailored to fit their own needs. (Contract Information Bulletin 87-5, January 14, 1987.) We found, however, that the missions in Ecuador and Bolivia had not established contract close-out procedures as directed, and according to AID's Procurement Executive, several other overseas missions also have not established adequate contract close-out procedures. For example, during his 1988 assessments at six missions in Africa, Latin America, and the Caribbean, the Procurement Executive found that contract close outs were generally not being done.

Lack of Agency Reporting on Contract Close Out

AID monitors the number of AID/Washington contracts that have expired and the number that have been closed out. However, for overseas missions, it only tracks the contracts that have expired. AID's Contract On Line Reporting System shows that from October 1, 1983, through March 31, 1989, 2,718 mission contracts valued at \$737.7 million had expired. Whether closeout procedures were completed on these contracts was unknown because the overseas missions do not routinely report this information.

Data show that of the 3,190 contracts administered in Washington by the Office of Procurement, which expired from October 1, 1983, through April 30, 1989, 1,361, or about 43 percent, had been closed out. Over 1,000 contracts, grants, and cooperative agreements completed prior to 1983 were closed administratively without following formal close-out procedures. This effort, however, does not include mission contracts, nor

¹ Excess funds from contracts funded by direct appropriation are deobligated, and depending on the accounts involved are either reprogrammed or returned to the Treasury. Excess funds from contracts funded under bilateral agreements are decommitted and returned to the respective project.

does it include AID/Washington contracts awarded by organizations other than the Office of Procurement.

The benefit of closing out expired contracts has been demonstrated by the AID/Washington Office of Procurement and the mission in Pakistan. According to Office of Procurement records, about \$9 million was deobligated as of June 1989 by closing out expired AID/Washington contracts. According to the AID Competition Advocate, the mission in Pakistan recently established comprehensive close-out procedures that could be considered a model for other missions. He said that approximately \$240,000 was deobligated because of contract close outs in that country.

Limited Contract Audit Coverage

Contract close-out procedures state that the office administering the contract is responsible for ensuring that a contract audit is conducted. AID's policy on contract close outs for Washington-administered contracts requires a final audit of costs for contracts worth \$500,000 or more. These audits are the responsibility of the Regional Inspector General for AID/Washington. Contracts valued at less than \$500,000 are to receive a desk review of costs by the responsible office, unless the contracting officer believes a cost audit is necessary. The missions have been instructed to use this policy as a guide in establishing their close-out procedures; however, we found that no clear threshold for requesting a final audit of mission contract costs has been established.

In examining AID's contract information system, we found that AID cannot accurately identify the extent that its expired contracts have or have not been audited. Neither AID/Washington nor the missions in Ecuador and Bolivia keep track of this information.

During our review we found several indicators that audit coverage is a problem area in the administration of AID contracts. For example, in a 1986 memorandum, AID's Procurement Executive stated that, based on internal evaluations of the Agency's contracting system, contract officers in Washington and overseas believed that they were receiving insufficient audit support in routine contract functions, including close outs.

We obtained the views of several overseas contract officers concerning the adequacy of final audit coverage for completed contracts. Their general view was that such coverage was inadequate. Factors cited as contributing to the problem included low mission priority, lack of

procedures for contract close out, and limited AID Inspector General resources to respond to audit requests.

The March 1985 AID Inspector General report on deficiencies in the close out of expired AID contracts suggests that the problem of limited audit coverage has affected AID's contracting system for years. The report stated that final audits, when required, were not requested for many of the expired contracts, and that final audits were not being systematically requested by contracting officers. The Inspector General said that such conditions applied to a substantial portion of all expired AID contracts.

Another problem in providing contract audit coverage is the current backlog of requests for final audits. For example, the Regional Inspector General for AID/Washington, who is responsible for auditing contractors based in the United States, stated that because of staff limitations, his office has a 3-year backlog of contract close-out audit requests that have not been performed. He also stated that the Defense Contract Audit Agency, which also audits AID contracts when requested, is about 2 years behind in performing contract close-out audits. He stated that the lack of agencywide reporting on audit coverage makes it impossible to determine the extent to which completed contracts are receiving final cost audits.

Lack of Reporting on Audit Activities

Because AID lacks an adequate reporting system for mission close-out actions, it is not possible to determine whether individual missions have established sound audit requirements, whether these requirements are consistent with current policy guidance, or to what extent these requirements are being met. The Inspector General has attempted to maintain an inventory of all audits requested for AID contracts and the status of these requests from data in the Agency's contract information system. However, the system does not keep track of the universe of expired AID contracts so that this information can be compared with audits requested and performed.

AID is in the process of implementing a new contract information system which, according to system design documents, will be capable of keeping track of contract expiration dates, the dates of contract audit requests and completion, and the date the contract is closed out. With this system the AID Inspector General and contract management officials should be able to monitor compliance with federal regulations governing contract close out and audit coverage.

Financial Integrity Act Issues

The Financial Integrity Act requires each executive agency to annually assess the adequacy of its internal controls and submit a year-end statement to the President and the Congress on the results of this assessment. We noted that AID's latest internal control assessment report, dated December 29, 1988, cited the lack of adequate audit coverage as a material internal control weakness. However, it did not address the other two control weaknesses discussed in our report—inadequate accountability of project-funded nonexpendable property in the possession of contractors and the lack of adequate contract close outs. We were unable to determine specifically why AID did not include these two control weaknesses in their assessment report.

Conclusions and Recommendations

Based on our review, we believe that AID has not been exercising adequate accountability and control over project-funded nonexpendable property in the possession of contractors, or ensuring that expired contracts are properly closed out and audited. To correct these areas of vulnerability, we recommend that the AID Administrator

- develop an inventory of AID-owned and cooperating country titled nonexpendable property in the possession of contractors and, based on the significance of this inventory, develop and implement an appropriate system for the proper accountability and control of such property;
- ensure that specific requirements for contract close outs are established for the overseas missions, including standard requirements or thresholds for final contract audits;
- ensure that the Agency's new contract information system is used to keep track of the extent that expired contracts are being closed out and audited for both AID/Washington and the overseas missions; and
- develop a plan for eliminating the backlog of completed but unaudited contracts.

Agency Comments and Our Evaluation

AID generally agreed with the matters discussed in our report but did not fully address our recommendations in its written comments (see app. II). The Chief of AID's procurement policy staff told us that AID would address our recommendations more fully after our final report is issued.

AID stated that it has taken some steps to correct the problems discussed in our report, and that it recognizes more effort is needed to assure better management over project-funded nonexpendable property, contract close outs, and final contract audits. AID stated that it will (1) review its

current regulations that require an accounting of nonexpendable property to determine whether they can be modified for easier implementation and (2) consider requiring reports for limited types of nonexpendable property. AID also stated that it has made contract close outs a consideration in the review and certification of contracting systems, and a more simplified system for close outs is being developed.

In developing its more simplified system for closing out contracts, we would urge that AID include standard requirements or thresholds for final contract audits and track expired contracts to ensure that they are closed out and audited.

We are sending copies of this report to the Senate Committee on Foreign Relations, other concerned congressional committees, the Acting Administrator of AID, and the Director, Office of Management and Budget. We will also make copies available to others upon request.

This report was prepared under the direction of Harold J. Johnson, Director, Foreign Economic Assistance Issues. He can be reached at (202) 275-5790, if you or your staff have any questions. Other major contributors are listed in appendix III.

Sincerely yours,



Frank C. Conahan
Assistant Comptroller General

Contents

| | |
|--|----------|
| Letter | 1 |
| Appendix I Objective, Scope, and Methodology | 12 |
| Appendix II Comments From the Agency for International Development | 13 15 |
| Appendix III Major Contributors to This Report | 16 |

Abbreviation

AID Agency for International Development

Objective, Scope, and Methodology

At the request of the Chairman, House Committee on Foreign Affairs, we are reviewing options for streamlining and revising the contracting and procurement system of the Agency for International Development (AID). As part of that overall review, this report examines selected areas of internal control and accountability in AID's system for contract administration.

We examined the AID's accounting for AID-owned and cooperating country titled nonexpendable property in the possession of contractors and its close out and audit of expired contracts to determine if these activities were being performed in accordance with federal and AID contract policies and regulations. We reviewed contract files and discussed related matters with AID officials at AID/Washington and at the AID missions in Quito, Ecuador, and La Paz, Bolivia. We analyzed federal and AID Acquisition Regulations; other applicable agency policies and guidelines; and AID Inspector General and other internal audit and evaluation reports covering nonexpendable property, audit coverage, and close outs of AID contracts. We also reviewed AID's latest internal control assessment report performed in compliance with the Financial Integrity Act to determine if it addressed the internal control weaknesses included in our report.

AID provided written comments on a draft of this report, which are discussed in the report and are presented in full in appendix II. Our survey was made in accordance with generally accepted government auditing standards and was performed between October 1988 and August 1989.

Comments From the Agency for International Development

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

NOV 3 1989

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and
International Affairs Division
General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

This is to provide our comments on the draft report entitled FOREIGN AID: Inadequate Controls over Non-expendable Property and Insufficient Contract Closeouts which was sent to Acting Administrator Mark Edelman by letter dated October 19.

The draft audit report covers two areas of long-standing concern to AID. We recognize that AID has not maintained complete accounts of non-expendable property (NXP) in the custody of its contractors and that AID does not have systems in place everywhere to assure final audit and closeout of all of its contracts. As the report notes, past AID audits and evaluations have also identified these areas. We have taken some steps to try to correct the problems, and we recognize that effort is needed to assure better management of these aspects of our contracts.

AID has for some time had regulations in place that require an accounting of NXP in the possession of contractors. The problem has been in implementing the very labor intensive regulations. We will review the regulations to determine whether they can be modified in order to be more easily implemented and monitored. Given the lifespan of many of AID's contracts, much NXP is expended by the end of the project - its useful life completed. AID will consider whether it might be more effective if NXP reports were required for more limited types of commodities/equipment, taking into account expected lifespan, value, and other pertinent factors. While automation may help with tracking, with each additional reporting requirement we risk being bogged down with paperwork to the detriment of our basic purpose.

See Comment 1

Appendix II
Comments From the Agency for
International Development

-2-

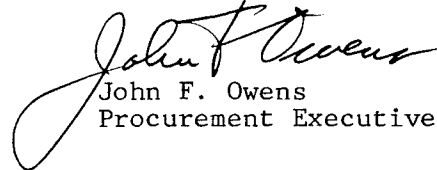
Concerning final audits and closeout of contracts, we have already made substantial efforts to assure that Missions establish systems to assure contract closeout. AID/W has provided to the Missions a sample system that they can use, and a more simplified system is now in the final stages of development. AID has made closeouts a basic consideration in the review and certification of contracting systems within the Agency. If it is discovered during a contracting system review that a Mission does not close out contracts, the need to do so is a prominent recommendation in the report from the Procurement Executive to the Mission Director on the results of the review. One editorial point concerning closeout deserves correction. The sentence which finishes at the top of page 10, states that over 1,000 contracts, grants, and cooperative agreements completed prior to 1983 were closed without proper closeout procedures. It is more appropriate and accurate to say that they were closed administratively without following formal closeout procedures.

See Comment 2

In summary, we recognize the importance of properly managing the Agency's contracts, and we will take steps to assure better accounting of NXP and more timely closeout of contracts. At the same time it should be noted that, given the current staff and funding resources, accomplishing this task will mean reallocating resources that would otherwise go to program activities.

See Comment 1

Sincerely,



John F. Owens
Procurement Executive

GAO Comments

(1) The wording in the text has been revised to incorporate this suggested change.

(2) Proper stewardship of resources is a basic part of program management and the lack of adequate internal controls can be detrimental to accomplishing the program's objectives. Reasonable internal controls equates to a satisfactory level of confidence that the objectives will be accomplished given considerations of costs, benefits, and risks. Our survey has indicated that improved controls can lead to better use of available resources.

Major Contributors to This Report

National Security and
International Affairs
Division, Washington,
D.C.

Albert H. Huntington, Assistant Director
Lynn B. Moore, Adviser
Norman T. Thorpe, Evaluator-in-Charge
Jesus A. Martinez, Evaluator
Donna J. Byers, Evaluator